

Internal Revenue Service

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PLR-135663-10

Date: January 27, 2011

X =

Y =

A =

B =

C =

D =

E =

F =

G =

H =

State =

Date =

1
Date =

2
Date =

3
Date =

4
Year =

1
Year =

2
n1 =

n2 =

n3 =

n4 =

Dear :

This letter responds to a letter dated August 27, 2010, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling that rental income received by Y and Y's subsidiaries is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on Date 1, and elected under § 1362(a) to be an S corporation effective Date 2. X is the sole shareholder of Y, which was incorporated in State on Date 3 and, in turn, Y is the sole shareholder of A, B, C, D, E, F, G, and H (collectively, "Subsidiaries"). Y and Subsidiaries own, lease, and manage commercial real estate properties (collectively, the "Properties"). X and Y both have accumulated earnings and profits. X intends to make qualified subchapter S subsidiary elections (QSub) under § 1361(b)(3)(B)(ii) for Y and Subsidiaries effective Date 4.

X represents that Y and Subsidiaries, through their employees or independent contractors, provide certain services with respect to the leasing of the Properties. These services involve maintaining and repairing water, sewer, fire sprinkler and irrigation systems, roof and structural components, landscaping, exterior lighting, exterior loading areas, parking areas, sidewalks, driveways, and debris, and providing security in common areas. X further represents that Y and Subsidiaries negotiate leases, collect rents, and monitor compliance with lease terms.

For the tax years ending in Year 1 and Year 2, Y and Subsidiaries collected approximately \$n1 and \$n2, respectively, in gross rents and paid or incurred approximately \$n3 and \$n4, respectively, in relevant operating expenses excluding depreciation.

Section 1361(a)(1) defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. The termination is effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i). Section 1362(d)(3)(A)(ii).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income.

Section 1.1362-2(c)(5)(ii)(B)(1) defines “rent” as amounts received for the use of, or right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that the term “rents” does not include rents derived in the active trade or business of renting property. Rents are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts and representations submitted, if X makes valid QSub elections for Y and Subsidiaries effective Date 4, the rental income that Y and Subsidiaries derive from Properties will not be passive investment income as described in § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning

the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion on whether X is a small business corporation eligible to be an S corporation nor whether Y or Subsidiaries are eligible to be qualified subchapter S subsidiaries under § 1361(b)(3). Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Charlotte Chyr
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes